Assembly Bill No. 511

CHAPTER 107

An act to amend Sections 10754.2, 17052.12, 17151, 17276, 23609, and 24416 of, to add Section 10903 to, and to add and repeal Sections 6378.1 and 17053.80 of, the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor, to take effect immediately, tax levy.

[Approved by Governor July 7, 2000. Filed with Secretary of State July 10, 2000.]

LEGISLATIVE COUNSEL'S DIGEST

AB 511, Alquist. Taxation.

The Sales and Use Tax Law provides various exemptions from that tax. Existing law authorizes cities, counties, and cities and counties to impose local sales and use taxes or transactions and use taxes, and provides that exemptions from state sales and use tax are incorporated into those local taxes.

This bill would, on or after January 1, 2001, and before January 1, 2006, additionally exempt tangible personal property purchased by eligible entities, as defined, that locate or expand a business in a California county with a specified unemployment rate and that qualify for receiving this Rural Investment Tax exemption by the California Infrastructure and Economic Development Bank (CIEDB) board.

The Vehicle License Fee (VLF) Law establishes, in lieu of any ad valorem property tax upon vehicles, an annual license fee for any vehicle subject to registration in this state in the amount of 2% of the market value of that vehicle, as specified. The VLF law permanently offsets the amount of the vehicle license fee for each subject vehicle by 25% and, for vehicle license fees with a final due date in the 2000 calendar year, offsets the fee amount for each subject vehicle by 35%. The VLF law also provides, depending upon factors that include whether forecasted General Fund revenues for certain fiscal years are within certain revenue target ranges, for a superseding offset percentage of 35%, 46.5%, 55%, or 67.5% to apply to specified future calendar years. The VLF law requires the Department of Finance, in any of certain fiscal years for which that department estimates a cumulative General Fund reduction of more than $100,000,000 as a result of state tax law changes on or after January 1, 1999, to apply that cumulative reduction, in accordance with specified formulas, to reduce target revenue ranges and to proportionately reduce the percentage amounts of superseding vehicle license fee offsets.

As amended by AB 858, the Vehicle License Fee Law provides for a minimum vehicle license fee offset of 35% in 2001 and 2002, an additional offset in those same years that results in a combined offset of 67.5%, and a single vehicle license fee offset of 67.5% for 2003 and each year thereafter.

This bill would appropriate the sum of $2,052,000,000 for transfer to a newly created special fund for payment by the Controller, as provided, of additional vehicle license fee offsets for the 2000–01 and 2001–02 fiscal years. This bill would also authorize the Governor to direct the Controller to send a notice, as provided, with each payment of an additional vehicle license fee offset. This bill would make changes to clarify the amendments made to the Vehicle License Fee Law by AB 858, and would require the Department of Motor Vehicles to report monthly and year-to-date dollars amounts to the Controller with respect to the additional vehicle license fee offsets.

The Personal Income Tax Law authorizes various credits against the taxes imposed by that law.

This bill would, for each taxable year beginning on or after January 1, 2000, and before January 1, 2005, allow a credit in an amount equal to $500 multiplied by the number of applicable individuals with respect to whom the taxpayer is an eligible caregiver for the taxable year.

The Personal Income Tax Law and the Bank and Corporation Tax Law, by reference to a specified federal statute, allow a credit against taxes imposed by those laws for increasing research expenses, as defined. In general, the amount of the credit under both laws is equal to 12% of the excess of the qualified research expenses, as defined, for the taxable or income year over the base amount and, in addition, for purposes of the Bank and Corporation Tax Law, 24% of the basic research payments, as defined. The term ‘‘base amount’’ means the product of the average annual gross receipts of the taxpayer for each of the specified years preceding the taxable or income year and the fixed-base percentage, as defined, but in no event less than 50% of the qualified research expenses for the taxable or income year. Existing law permits, for taxable and income years beginning on or after January 1, 1998, a taxpayer to elect an alternative incremental credit, based on a specified formula.

This bill would, under both laws, for each taxable or income year beginning on or after January 1, 2000, provide that the credit for increasing research expenses shall be equal to 15% of the qualified research expenses. This bill would also revise that formula by changing certain state modifications to the federal formula to increase the amount of the alternative incremental credit allowed under state law, as provided.

The Personal Income Tax Law provides for an exclusion from the gross income of an employee with respect to the taxes imposed by that law for amounts paid or incurred by an employer for educational assistance to the employee, as specified, up to $5,250 during a calendar year. However, educational assistance does not include any course or education taken at the graduate level beginning after June 30, 1996, of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree.

This bill would remove that exception for any course or education taken at the graduate level beginning after January 1, 2000, thereby including those courses or education within the definition of educational assistance.

The Personal Income Tax Law and the Bank and Corporation Tax Law authorize a net operating loss deduction against the taxes imposed by those laws that generally permits those losses to be carried forward 5 taxable or income years, as specified, but provides that 50% of the entire amount of the net operating loss for any taxable or income year is not eligible for carryover to any subsequent taxable or income year, except as specified.

This bill would, for each taxable or income year beginning on or after January 1, 2000, and before January 1, 2002, allow 55% of the entire amount of net operating loss to be carried forward; for each taxable or income year beginning on or after January 1, 2002, and before January 1, 2004, would allow 60% of the entire amount of net operating loss to be carried forward; and for each taxable or income year beginning on or after January 1, 2004, would allow 65% of the entire amount of the net operating loss to be carried forward. This bill would also provide that a net operating loss attributable to any taxable or income year beginning on or after January 1, 2000, shall be a net operating loss to each of the 10 taxable or income years following the taxable or income year of the loss.

This bill would take effect immediately as a tax levy, but the operation of certain of its provisions would depend upon the enactment of another bill.

Appropriation: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 6378.1 is added to the Revenue and Taxation Code, to read:

6378.1. (a) On and after January 1, 2001, and before January 1, 2006, there are exempted from the taxes imposed by this part, the gross receipts from the sale in this state of, and the storage, use, or other consumption in this state of, tangible personal property purchased by eligible entities, as defined in subdivision (f).

(b) The exemption provided under this part shall be termed the Rural Investment Tax exemption.

(c) The California Infrastructure and Economic Development Bank (CIEDB) board shall develop a program that determines who is eligible to receive this exemption, monitor entities for compliance with the requirements of this section, and notify the State Board of Equalization, as provided in this section. The CIEDB shall determine the amount of the exemption available to each entity.

(d) Entities wishing to qualify for this exemption shall apply to the CIEDB board in a manner prescribed by the CIEDB board. The CIEDB board shall provide all applicants written notification stating the eligibility of the applicant to receive an exemption under this section.

(e) The annual amount of exemptions that may be granted pursuant to this section shall not exceed five million dollars ($5,000,000) per year. The CIEDB board shall not authorize any exemption that would cause the total amount of exemptions authorized with respect to any calendar year under this section to exceed five million dollars ($5,000,000).

(f) For purposes of this section:

(1) ‘‘Eligible entity’’ means an entity that complies with all of the following:

(A) The entity shall locate or expand a business in a California county with an average annual unemployment rate of five percentage points or more above the statewide average for the most recent calendar year as determined by the State of California, Employment Development Department.

(B) The entity shall make a new investment of at least one hundred fifty million dollars ($150,000,000) in the county in which the entity locates its business and shall maintain this level of investment for a period of at least 24 months after the CIEDB board certifies that the entity has become an eligible entity.

(C) The entity shall employ at least 500 new full-time equivalent employees in the county, including employees who are employed directly by the entity and employees who are hired by supporting industries. Employees shall be employed for at least 24 months after the CIEDB certifies that the entity has become eligible. At least 175 of the new full-time equivalent employees shall be directly employed by the entity.

(2) ‘‘New full-time equivalent employees’’ means employees hired by the entity seeking the exemption allowed under this part and not employees moved, transferred, or displaced from other places of business of the entity within this state.

(3) ‘‘Tangible personal property’’ means machinery and equipment, including component parts.

(4) ‘‘Tangible personal property’’ does not include any of the following:

(A) Tangible personal property that is used primarily in administration, general management, or marketing.

(B) Furniture, inventory, or equipment used to store products.

(C) Any property for which a credit is claimed under either Section 17053.49 or 23649 of the Revenue and Taxation Code.

(g) Prior to claiming an exemption under this section, the eligible entity shall apply to the State Board of Equalization for an exemption certificate and shall include a copy of the written notification from the CIEDB board stating that the entity applying for the exemption certificate is eligible to receive an exemption under this section. No exemption shall be allowed under this section unless the eligible entity furnishes the retailer with an exemption certificate, completed in accordance with any instruction or regulations as the State Board of Equalization may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate. The exemption certificate shall contain the sales price of the machinery and equipment that is exempt pursuant to subdivision (a).

(h) (1) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section shall not apply with respect to any tax levied by a county, city, or district pursuant to, or in accordance with, either of these laws.

(2) The exemption established by this section shall not apply with respect to any tax levied pursuant to Sections 6051.2 and 6201.2, or pursuant to Section 35 of Article XIII of the California Constitution.

(3) The exemption established by this section shall not apply to any sale or use of property that, within one year from the date of purchase, is either removed from a California county as described in subparagraph (A) of paragraph (1) of subdivision (f), or converted from an exempt use under subdivision (a) to some other use not qualifying for the exemption.

(i) (1) If a purchaser certifies in writing to the seller that the property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and within one year from the date of purchase, the purchaser (1) removes that property outside a California county as described in subparagraph (A) of paragraph (1) of subdivision (f), or (2) converts that property for use in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the property at the time the property is so removed, converted, or used, and the sales price of the property to the purchaser shall be deemed the gross receipts from that retail sale.

(2) The purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the property if the purchaser does not achieve the level and duration of employment and investment pursuant to subdivision (f)

within three years from the date the entity first uses an exemption under this section. The CIEDB board may extend this time period by a maximum of 12 months for reasonable cause.

(j) (1) The CIEDB board shall determine if entities have fulfilled the requirements necessary in order to keep this exemption and shall report to the State Board of Equalization on entities that have not fulfilled these requirements.

(2) Notwithstanding Section 6902, the State Board of Equalization shall, within one year after being notified by the CIEDB board that an entity has not fulfilled the requirements of this section, examine the books and records of the entity, and issue a determination of any liabilities due.

(k) The CIEDB board shall provide a report to the Legislature, the Department of Finance, and the State Board of Equalization no later than January 15 following each fiscal year the program is in operation. The report shall include, at a minimum, all of the following:

(1) The entities that have been provided the exemption established by this section and the amount of the exemption authorized by the CIEDB board to each entity.

(2) The number of new persons employed by each entity.

(3) The amount of investment made by each entity.

(4) A description of the economic development provided by each entity receiving the exemption.

(5) A description of each entity that has fulfilled the requirements of paragraph (1) of subdivision (f).

(6) A description of each entity that has not fulfilled the requirements of paragraph (1) of subdivision (f).

(*l*) (1) This section shall become operative on the first day of the first calendar quarter commencing more than 90 days after the effective date of this act.

(2) This section shall remain in effect only until January 1, 2006, and as of that date is repealed.

SEC. 2. Section 10754.2 of the Revenue and Taxation Code, as added by AB 858 of the 1999–2000 Regular Session, is amended to read:

10754.2. Notwithstanding any other provision of law to the contrary, all of the following apply to vehicle license fees with a final due date on or after January 1, 2001:

(a) (1) For each vehicle license fee for the initial or original registration of any vehicle, never before registered in this state, or for any renewal of registration, with a final due date in 2001 or 2002, for which the vehicle license fee offset required by Section 10754 is less than 67 $^1/_2$ percent, the Department of Motor Vehicles shall concurrently calculate an offset, in addition to the offset required by Section 10754, that is equal to the difference between the following:

(A) A vehicle license fee offset of 67 $^1/_2$ percent.

(B) A vehicle license fee offset of the greater of 35 percent or that percentage required by Section 10754.

(2) The Department of Motor Vehicles shall, for each calendar month, report to the Department of Finance and the Controller the amount of each offset calculated pursuant to paragraph (1) for that calendar month and the name and address of the taxpayer to whom that additional offset applies. The Controller shall, within 30 days after receiving a monthly report from the Department of Motor Vehicles, make payment of the reported additional offsets to the identified taxpayers. The Governor may direct the Controller to include, with each payment pursuant to this paragraph of an additional vehicle license fee offset, a notice stating that the additional vehicle license fee offsets required by this paragraph constitute a Prosperity Dividend approved by the Legislature and signed by Governor Davis.

(3) (A) For each vehicle license fee, for the initial or original registration of any vehicle, never before registered in this state, or for any renewal of registration, with a final due date in 2001 or 2002, the vehicle license fee offset implemented pursuant to Section 10754 shall be not less than 35 percent.

(B) For each vehicle license fee, for the initial or original registration of any vehicle, never before registered in this state, or for any renewal of registration with a final due date in 2003 or any calendar year thereafter, there shall be a $67^1/_2$ percent offset as described in paragraph (5) of subdivision (a) of Section 10754, as that section read on January 1, 2000. In no event may the $67^1/_2$ percent offset established by this subparagraph be reduced pursuant to paragraph (4) of subdivision (c) of Section 10754, or any successor to that paragraph.

(b) (1) The additional vehicle license fee offsets established by subdivision (a) shall be funded from those amounts to be appropriated by statute.

(2) Revenue losses to cities, counties, and cities and counties resulting from this section shall be reimbursed by the Controller from the General Fund in the same manner as provided in Section 11000. The amounts of General Fund transfers required by this subdivision are deemed to be vehicle license fee proceeds and vehicle license fee revenues for those same purposes as set forth in subdivision (d) of Section 11000, and are subject to the same pledges, liens, encumbrances, and priorities as described in that subdivision.

SEC. 3. Section 10903 is added to the Revenue and Taxation Code, to read:

10903. (a) Notwithstanding Section 13340 of the Government Code, there is hereby appropriated from the General Fund the sum of two billion fifty-two million dollars ($2,052,000,000) for transfer by the Controller, upon notification by the Director of Finance during the 2000–01 fiscal year, to the Special Reserve Fund for Vehicle

License Fee Tax Relief, which is hereby created as a special fund. The amounts appropriated by this subdivision for transfer to the Special Reserve Fund for Vehicle License Fee Tax Relief shall be expended exclusively for the payment of additional vehicle license fee offsets calculated under Section 10754.2, and are allocated for that purpose as follows:

(1) Eight hundred and eighty-seven million dollars ($887,000,000) for the payment of additional vehicle license fee offsets for the 2000–01 fiscal year.

(2) One billion one hundred sixty five million dollars ($1,165,000,000) for the payment of additional vehicle license fee offsets for the 2001–02 fiscal year.

(b) The Department of Motor Vehicles shall provide both of the following notices to the Controller in connection with each monthly report pursuant to Section 10754.2 of additional vehicle license fee offsets calculated by that department pursuant to that section:

(1) A notice for each month of the total dollar amount of the additional vehicle license fee offsets calculated by the department during that month pursuant to Section 10754.2.

(2) A notice of the total dollar amount of the additional vehicle license fee offsets calculated by the department pursuant to Section 10754.2 for the calendar year to the date of each monthly report provided pursuant to Section 10754.2.

SEC. 4. Section 17052.12 of the Revenue and Taxation Code is amended to read:

17052.12. For each taxable year beginning on or after January 1, 1987, there shall be allowed as a credit against the ‘‘net tax’’ (as defined by Section 17039) for the taxable year an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each taxable year beginning before January 1, 1997, the reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘8 percent.’’

(b) (1) For each taxable year beginning on or after January 1, 1997, and before January 1, 1999, the reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘11 percent.’’

(2) For each taxable year beginning on or after January 1, 1999, and before January 1, 2000, the reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘12 percent.’’

(3) For each taxable year beginning on or after January 1, 2000, the reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘15 percent.’’

(c) Section 41(a)(2) of the Internal Revenue Code, relating to basic research payments, shall not apply.

(d) ‘‘Qualified research’’ shall include only research conducted in California.

(e) In the case where the credit allowed under this section exceeds the ‘‘net tax,’’ the excess may be carried over to reduce the ‘‘net tax’’ in the following year, and succeeding years if necessary, until the credit has been exhausted.

(f) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of ‘‘qualified research expense’’ any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) For each taxable year beginning on or after January 1, 1998, the reference to ‘‘Section 501(a)’’ in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read ‘‘this part or Part 11 (commencing with Section 23001).’’

(g) (1) For each taxable year beginning on or after January 1, 1998, and before January 1, 2000:

(A) The reference to ‘‘1.65 percent’’ in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read ‘‘one and thirty-two hundredths of one percent.’’

(B) The reference to ‘‘2.2 percent’’ in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read ‘‘one and seventy-six hundredths of one percent.’’

(C) The reference to ‘‘2.75 percent’’ in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read ‘‘two and two-tenths of one percent.’’

(2) For each taxable year beginning on or after January 1, 2000:

(A) The reference to ‘‘1.65 percent’’ in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read ‘‘one and forty-nine hundredths of one percent.’’

(B) The reference to ‘‘2.2 percent’’ in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read ‘‘one and ninety-eight hundredths of one percent.’’

(C) The reference to ‘‘2.75 percent’’ in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read ‘‘two and forty-eight hundredths of one percent.’’

(3) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made for any taxable year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

(4) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business that is

delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(h) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(i) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (e); except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

SEC. 5. Section 17053.80 is added to the Revenue and Taxation Code, to read:

17053.80. (a) For each taxable year beginning on or after January 1, 2000, and before January 1, 2005, there shall be allowed as a credit against the ‘‘net tax,’’ as defined in Section 17039, an amount equal to five hundred dollars ($500) multiplied by the number of applicable individuals with respect to whom the taxpayer is an eligible caregiver for the taxable year.

(b) (1) (A) ‘‘Applicable individual’’ means, with respect to any taxable year, any individual who has been certified, before the due date for filing the return of tax for the taxable year (without extensions), by a physician (as defined in Section 1861(r)(1) of the Social Security Act) as being an individual with long-term care needs described in subparagraph (B) for a period--

(i) which is at least 180 consecutive days, and

(ii) a portion of which occurs within the taxable year.

That term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the $39^1/_2$ month period ending on that due date (or such other period as the Franchise Tax Board prescribes) a physician (as so defined) has certified that that individual meets those requirements.

(B) An individual is described in this subparagraph if the individual meets any of the following requirements:

(i) The individual is at least six years of age and--

(I) is unable to perform (without substantial assistance from another individual) at least three activities of daily living, as defined in Section 7702B(c)(2)(B) of the Internal Revenue Code, due to a loss of functional capacity, or

(II) requires substantial supervision to protect that individual from threats to health and safety due to severe cognitive impairment and is unable to perform at least one activity of daily living, as defined in Section 7702B(c)(2)(B) of the Internal Revenue Code, or to the extent provided by the Franchise Tax Board (in consultation with the

Secretary of Health and Welfare Agency), is unable to engage in age appropriate activities.

(ii) The individual is at least two years of age but less than six years of age and is unable due to a loss of functional capacity to perform (without substantial assistance from another individual) at least two of the following activities: eating, transferring, or mobility.

(iii) The individual is under two years of age and requires specific durable medical equipment by reason of a severe health condition or requires a skilled practitioner trained to address the individual's condition to be available if the individual's parents or guardians are absent.

(2) (A) A taxpayer shall be treated as an ‘‘eligible caregiver’’ for any taxable year with respect to the following individuals:

(i) The taxpayer.

(ii) The taxpayer's spouse.

(iii) An individual with respect to whom the taxpayer is allowed a credit under subdivision (d) of Section 17054 for the taxable year.

(iv) An individual who would be described in clause (iii) for the taxable year if Section 151(c)(1)(A) of the Internal Revenue Code, relating to gross income limitation, were applied by substituting for the federal exemption amount specified in that section, an amount equal to the sum of the federal exemption amount specified in that section, the federal standard deduction under Section 63(c)(2)(C) of the Internal Revenue Code, and any additional federal standard deduction under Section 63(c)(3) of the Internal Revenue Code which would be applicable to the individual if clause (iii) applied.

(v) An individual who would be described in clause (iii) for the taxable year if--

(I) the requirements of clause (iv) are met with respect to the individual, and

(II) the requirements of subparagraph (B) are met with respect to the individual in lieu of the support test of Section 152(a) of the Internal Revenue Code.

(B) The requirements of this subparagraph are met if an individual has as his or her principal place of abode the home of the taxpayer, and

(i) in the case of an individual who is an ancestor or descendant of the taxpayer or the taxpayer's spouse, is a member of the taxpayer's household for over half the taxable year, or

(ii) in the case of any other individual, is a member of the taxpayer's household for the entire taxable year.

(C) (i) If more than one individual is an eligible caregiver with respect to the same applicable individual for taxable years ending with or within the same calendar year, a taxpayer shall be treated as the eligible caregiver if each of those individuals (other than the taxpayer) files a written declaration (in the form and manner as the

Franchise Tax Board may prescribe) that that individual will not claim that applicable individual for the credit under this section.

(ii) If each individual required under clause (i) to file a written declaration under clause (i) does not do so, the individual with the highest federal modified adjusted gross income (as defined in Section 32(c)(5) of the Internal Revenue Code for federal purposes) shall be treated as the eligible caregiver.

(iii) In the case of married individuals filing separate returns, the determination under this subparagraph as to whether the husband or wife is the eligible caregiver shall be made under the rules of clause (ii) (whether or not one of them has filed a written declaration under clause (i)).

(c) (1) No credit shall be allowed under this section to a taxpayer with respect to any applicable individual unless the taxpayer includes the name and taxpayer identification number of that individual, and the identification number of the physician certifying that individual, on the return of tax for the taxable year.

(2) The denial of any credit under paragraph (1) may be made pursuant to Section 19051.

(d) The taxpayer shall retain the physician certification required by subdivision (b) and shall make that certification available to the Franchise Tax Board upon request.

(e) No credit shall be allowed under this section for any eligible caregiver whose adjusted gross income for the taxable year is equal to or greater than one hundred thousand dollars ($100,000).

(f) This section shall remain in effect only until December 1, 2005, and as of that date is repealed.

SEC. 6. Section 17151 of the Revenue and Taxation Code is amended to read:

17151. (a) Gross income of an employee does not include any amounts, not exceeding an aggregate amount of five thousand two hundred fifty dollars ($5,250) per calendar year, that is paid or incurred by the employer for educational assistance to the employee pursuant to an educational assistance program.

(b) For purposes of this section, the following definitions shall apply:

(1) ‘‘Educational assistance’’ means the payment by an employer of expenses incurred by or on behalf of an employee for the employee’s education, and includes, but is not limited to, payments for books, supplies, equipment, tuition, and fees, and similar payments. ‘‘Educational assistance’’ includes the provision by an employer of courses of instruction for an employee, including the provision of books, supplies, and equipment. ‘‘Educational assistance’’ does not include any payment for, or the provision of, any of the following:

(A) Any tools or supplies that may be retained by the employee after completion of a course of instruction.

(B) Any meals, lodging, or transportation.
(C) Any course or education involving sports, games, or hobbies.
(D) Any course or education taken at the graduate level of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree. This subparagraph applies only to any course or education taken at the graduate level beginning after June 30, 1996, and before January 1, 2000.
(2) ‘‘Educational assistance program’’ means a separate written plan of an employer for the exclusive benefit of his or her employees to provide those employees with educational assistance. The program shall meet the following requirements:
(A) The program benefits employees who qualify under a classification established by the employer and found by the Franchise Tax Board not to be discriminatory in favor of employees who are highly compensated employees (within the meaning of Section 414(q) of the Internal Revenue Code) or their dependents. For purposes of this subparagraph, there shall be excluded from consideration employees who are not included in the program and who are included in a unit of employees covered by an agreement that the Franchise Tax Board finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that educational assistance benefits were the subject of good faith bargaining between the employee representatives and the employer or employers.
(B) Not more than 5 percent of the amounts paid or incurred by the employer for educational assistance during the year may be provided for the class of individuals who are owners (or their spouses or dependents), each of whom, on any day of the year, owns more than 5 percent of the capital or profits interest in the employer.
(C) The program does not provide eligible employees with a choice between educational assistance and other remuneration includable in gross income. For purposes of this section, the business practices of the employer, as well as the written program, shall be taken into account.
(D) The program need not be funded.
(E) Reasonable notification of the availability and terms of the program is provided to eligible employees.
(3) ‘‘Employee’’ includes self-employed individuals within the meaning of Section 401(c)(1) of the Internal Revenue Code.
(c) For purposes of this section:
(1) Any individual who owns the entire interest in an unincorporated trade or business shall be treated as his or her own employee.
(2) A partnership shall be treated as the employer of each partner who is an employee within the meaning of paragraph (3) of subdivision (b).

(3) (A) An educational assistance program shall not be considered to fail to meet any of the requirements of paragraph (2) of subdivision (b) on the sole basis of either of the following:

(i) Different utilization rates for the different types of educational assistance made available under the program.

(ii) Successful completion or attainment of a particular course grade is required for or considered in determining reimbursement under the program.

(B) This section shall not be construed to affect the deduction or inclusion in income of amounts that are paid or incurred or received as reimbursement for educational expenses under Section 117, 162, or 212 of the Internal Revenue Code.

(d) No deduction or credit shall be allowed to the employee with respect to any amount that the employee excludes from income pursuant to this section.

(e) Section 127 of the Internal Revenue Code shall not apply.

(f) This section shall apply with respect to expenses relating to courses beginning after June 30, 1996.

SEC. 7. Section 17276 of the Revenue and Taxation Code is amended to read:

17276. Except as provided in Sections 17276.1, 17276.2, 17276.4, 17276.5, and 17276.6, the deduction provided by Section 172 of the Internal Revenue Code, relating to a net operating loss deduction, shall be modified as follows:

(a) (1) Net operating losses attributable to taxable years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any taxable year beginning before January 1, 1987.

(b) (1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that the applicable percentage of the entire amount of the net operating loss for any taxable year shall be eligible for carryover to any subsequent taxable year. For purposes of this subdivision, the applicable percentage shall be:

(A) Fifty percent for any taxable year beginning before January 1, 2000.

(B) Fifty-five percent for any taxable year beginning on or after January 1, 2000, and before January 1, 2002.

(C) Sixty percent for any taxable year beginning on or after January 1, 2002, and before January 1, 2004.

(D) Sixty-five percent for any taxable year beginning on or after January 1, 2004.

(2) In the case of a taxpayer who has a net operating loss in any taxable year beginning on or after January 1, 1994, and who operates a new business during that taxable year, each of the following shall

apply to each loss incurred during the first three taxable years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in subdivision (d).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in subdivision (d).

(ii) With respect to the portion of the net operating loss which exceeds the net loss from the new business, the applicable percentage of that amount shall be carried forward as provided in subdivision (d).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(3) In the case of a taxpayer who has a net operating loss in any taxable year beginning on or after January 1, 1994, and who operates an eligible small business during that taxable year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the taxable years specified in subdivision (d).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward as provided in subdivision (d).

(ii) With respect to that portion of the net operating loss that exceeds the net loss from the eligible small business, the applicable percentage of that amount shall be carried forward as provided in subdivision (d).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three taxable years of the new business.

(5) In the case of a taxpayer who has a net operating loss in a taxable year beginning on or after January 1, 1994, and who operates more than one business, and more than one of those businesses

qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of that paragraph, paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, the term ‘‘net loss’’ means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) Net operating loss carrybacks shall not be allowed.

(d) (1) (A) For a net operating loss for any taxable year beginning on or after January 1, 1987, and before January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute ‘‘five taxable years’’ in lieu of ‘‘ 20 taxable years’’ except as otherwise provided in paragraphs (2) and (3).

(B) For a net operating loss for any taxable year beginning on or after January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute ‘‘10 taxable years’’ in lieu of ‘‘20 taxable years.’’

(2) For any taxable year beginning before January 1, 2000, in the case of a ‘‘new business,’’ the ‘‘five taxable years’’ in paragraph (1) shall be modified to read as follows:

(A) ‘‘Eight taxable years’’ for a net operating loss attributable to the first taxable year of that new business.

(B) ‘‘Seven taxable years’’ for a net operating loss attributable to the second taxable year of that new business.

(C) ‘‘Six taxable years’’ for a net operating loss attributable to the third taxable year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 17276.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to taxable years beginning in 1991.

(B) By two years for a net operating loss attributable to taxable years beginning prior to January 1, 1991.

(4) The net operating loss attributable to taxable years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 taxable years following the year of the loss if it is incurred by a taxpayer that is under the jurisdiction of the court in a Title 11 or similar case at any time during the income year. The loss carryover provided in the preceding sentence shall not apply to any loss incurred after the date the taxpayer is no longer under the jurisdiction of the court in a Title 11 or similar case.

(e) For purposes of this section:

(1) ‘‘Eligible small business’’ means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the taxable year.

(2) Except as provided in subdivision (f), ‘‘new business’’ means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) ‘‘Title 11 or similar case’’ shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(f) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first taxable year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (‘‘prior trade or business activity’’), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of

Management and Budget, 1987 edition, than are any of the taxpayer's (or any related person's) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) ''Related person'' shall mean any person that is related to the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) ''Acquire'' shall include any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(7) (A) For taxable years beginning on or after January 1, 1997, the term ''new business'' shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) ''Biopharmaceutical activities'' means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

(ii) ''Other biotechnology activities'' means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(g) In computing the modifications under Section 172(d)(2) of the Internal Revenue Code, relating to capital gains and losses of taxpayers other than corporations, the exclusion provided by Section 18152.5 shall not be allowed.

(h) Notwithstanding any provisions of this section, a deduction shall be allowed to a ‘‘qualified taxpayer’’ as provided in Sections 17276.1, 17276.2, 17276.4, 17276.5, and 17276.6.

(i) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(j) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

(k) Except as otherwise provided, the amendments made by the act adding this subdivision shall apply to net operating losses for taxable years beginning on or after January 1, 2000.

SEC. 8. Section 23609 of the Revenue and Taxation Code is amended to read:

23609. For each income year beginning on or after January 1, 1987, there shall be allowed as a credit against the ‘‘tax’’ (as defined by Section 23036) an amount determined in accordance with Section 41 of the Internal Revenue Code, except as follows:

(a) For each income year beginning before January 1, 1997, both of the following modifications shall apply:

(1) The reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘8 percent.’’

(2) The reference to ‘‘20 percent’’ in Section 41(a)(2) of the Internal Revenue Code is modified to read ‘‘12 percent.’’

(b) (1) For each income year beginning on or after January 1, 1997, and before January 1, 1999, both of the following modifications shall apply:

(A) The reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘11 percent.’’

(B) The reference to ‘‘20 percent’’ in Section 41(a)(2) of the Internal Revenue Code is modified to read ‘‘24 percent.’’

(2) For each income year beginning on or after January 1, 1999, and before January 1, 2000, both of the following shall apply:

(A) The reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘12 percent.’’

(B) The reference to ‘‘20 percent’’ in Section 41(a)(2) of the Internal Revenue Code is modified to read ‘‘24 percent.’’

(3) For each income year beginning on or after January 1, 2000, both of the following shall apply:

(A) The reference to ‘‘20 percent’’ in Section 41(a)(1) of the Internal Revenue Code is modified to read ‘‘15 percent.’’

(B) The reference to ‘‘20 percent’’ in Section 41(a)(2) of the Internal Revenue Code is modified to read ‘‘24 percent.’’

(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of ‘‘qualified research expense’’ any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax provided by Section 6378.

(2) ‘‘Qualified research’’ and ‘‘basic research’’ shall include only research conducted in California.

(d) The provisions of Section 41(e)(7)(A) of the Internal Revenue Code, shall be modified so that ‘‘basic research,’’ for purposes of this section, includes any basic or applied research including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except that the term does not include any of the following:

(1) Basic research conducted outside California.

(2) Basic research in the social sciences, arts, or humanities.

(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.

(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, or any other biotechnology research and development activities, the provisions of Section 41(e)(6) of the Internal Revenue Code shall be modified to include both of the following:

(A) A qualified organization as described in Section 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an institution of higher education as described in Section 3304(f) of the Internal Revenue Code.

(B) A charitable research hospital owned by an organization that is described in Section 501(c)(3) of the Internal Revenue Code, is exempt from taxation under Section 501(a) of the Internal Revenue Code, is not a private foundation, is designated a ‘‘specialized laboratory cancer center,’’ and has received Clinical Cancer Research Center status from the National Cancer Institute.

(2) For purposes of this subdivision:

(A) ‘‘Biopharmaceutical research activities’’ means those activities that use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities that make use of chemical compounds to produce commercial products.

(B) ‘‘Other biotechnology research and development activities’’ means research and development activities consisting of the application of recombinant DNA technology to produce commercial products, as well as research and development activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(f) In the case where the credit allowed by this section exceeds the ‘‘tax,’’ the excess may be carried over to reduce the ‘‘tax’’ in the following year, and succeeding years if necessary, until the credit has been exhausted.

(g) For each income year beginning on or after January 1, 1998, the reference to ‘‘Section 501(a)’’ in Section 41(b)(3)(C) of the Internal Revenue Code, relating to contract research expenses, is modified to read ‘‘this part or Part 10 (commencing with Section 17001).’’

(h) (1) For each income year beginning on or after January 1, 1998, and before January 1, 2000:

(A) The reference to ‘‘1.65 percent’’ in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read ‘‘one and thirty-two hundredths of one percent.’’

(B) The reference to ‘‘2.2 percent’’ in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read ‘‘one and seventy-six hundredths of one percent.’’

(C) The reference to ‘‘2.75 percent’’ in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read ‘‘two and two-tenths of one percent.’’

(2) For each income year beginning on or after January 1, 2000:

(A) The reference to ‘‘1.65 percent’’ in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read ‘‘one and forty-nine hundredths of one percent.’’

(B) The reference to ‘‘2.2 percent’’ in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read ‘‘one and ninety-eight hundredths of one percent.’’

(C) The reference to ‘‘2.75 percent’’ in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read ‘‘two and forty-eight hundredths of one percent.’’

(3) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made for any income year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the income year for which made and all succeeding income years unless revoked with the consent of the Franchise Tax Board.

(4) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(i) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(j) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any income year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other income years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent income year.

SEC. 9. Section 24416 of the Revenue and Taxation Code is amended to read:

24416. Except as provided in Section 24416.1, 24416.2, 24416.4, 24416.5, or 24416.6, a net operating loss deduction shall be allowed in computing net income under Section 24341 and shall be determined in accordance with Section 172 of the Internal Revenue Code, except as otherwise provided.

(a) (1) Net operating losses attributable to income years beginning before January 1, 1987, shall not be allowed.

(2) A net operating loss shall not be carried forward to any income year beginning before January 1, 1987.

(b) (1) Except as provided in paragraphs (2) and (3), the provisions of Section 172(b)(2) of the Internal Revenue Code, relating to the amount of carryovers, shall be modified so that the applicable percentage of the entire amount of the net operating loss for any income year shall be eligible for carryover to any subsequent income year. For purposes of this subdivision, the applicable percentage shall be:

(A) Fifty percent for any income year beginning before January 1, 2000.

(B) Fifty-five percent for any income year beginning on or after January 1, 2000, and before January 1, 2002.

(C) Sixty percent for any income year beginning on or after January 1, 2002, and before January 1, 2004.

(D) Sixty-five percent for any income year beginning on or after January 1, 2004.

(2) In the case of a taxpayer who has a net operating loss in any income year beginning on or after January 1, 1994, and who operates a new business during that income year, each of the following shall

apply to each loss incurred during the first three income years of operating the new business:

(A) If the net operating loss is equal to or less than the net loss from the new business, 100 percent of the net operating loss shall be carried forward as provided in subdivision (e).

(B) If the net operating loss is greater than the net loss from the new business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the new business, 100 percent of that amount shall be carried forward as provided in subdivision (e).

(ii) With respect to the portion of the net operating loss that exceeds the net loss from the new business, the applicable percentage of that amount shall be carried forward as provided in subdivision (d).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(3) In the case of a taxpayer who has a net operating loss in any income year beginning on or after January 1, 1994, and who operates an eligible small business during that income year, each of the following shall apply:

(A) If the net operating loss is equal to or less than the net loss from the eligible small business, 100 percent of the net operating loss shall be carried forward to the income years specified in paragraph (1) of subdivision (e).

(B) If the net operating loss is greater than the net loss from the eligible small business, the net operating loss shall be carried over as follows:

(i) With respect to an amount equal to the net loss from the eligible small business, 100 percent of that amount shall be carried forward as provided in subdivision (e).

(ii) With respect to that portion of the net operating loss that exceeds the net loss from the eligible small business, the applicable percentage of that amount shall be carried forward as provided in subdivision (e).

(C) For purposes of Section 172(b)(2) of the Internal Revenue Code, the amount described in clause (ii) of subparagraph (B) shall be absorbed before the amount described in clause (i) of subparagraph (B).

(4) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates a business that qualifies as both a new business and an eligible small business under this section, that business shall be treated as a new business for the first three income years of the new business.

(5) In the case of a taxpayer who has a net operating loss in an income year beginning on or after January 1, 1994, and who operates

more than one business, and more than one of those businesses qualifies as either a new business or an eligible small business under this section, paragraph (2) shall be applied first, except that if there is any remaining portion of the net operating loss after application of clause (i) of subparagraph (B) of paragraph (2), paragraph (3) shall be applied to the remaining portion of the net operating loss as though that remaining portion of the net operating loss constituted the entire net operating loss.

(6) For purposes of this section, ''net loss'' means the amount of net loss after application of Sections 465 and 469 of the Internal Revenue Code.

(c) For any income year in which the taxpayer has in effect a water's-edge election under Section 25110, the deduction of a net operating loss carryover shall be denied to the extent that the net operating loss carryover was determined by taking into account the income and factors of an affiliated corporation in a combined report whose income and apportionment factors would not have been taken into account if a water's-edge election under Section 25110 had been in effect for the income year in which the loss was incurred.

(d) Net operating loss carrybacks shall not be allowed.

(e) (1) (A) For a net operating loss for any income year beginning on or after January 1, 1987, and before January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute ''five income years'' in lieu of ''20 years'' except as otherwise provided in paragraphs (2), (3), and (4).

(B) For a net operating loss for any income year beginning on or after January 1, 2000, Section 172(b)(1)(A)(ii) of the Internal Revenue Code, relating to years to which net operating losses may be carried, is modified to substitute ''10 income years'' in lieu of ''20 income years.''

(2) For any income year beginning before January 1, 2000, in the case of a ''new business,'' the ''five income years'' referred to in paragraph (1) shall be modified to read as follows:

(A) ''Eight income years'' for a net operating loss attributable to the first income year of that new business.

(B) ''Seven income years'' for a net operating loss attributable to the second income year of that new business.

(C) ''Six income years'' for a net operating loss attributable to the third income year of that new business.

(3) For any carryover of a net operating loss for which a deduction is denied by Section 24416.3, the carryover period specified in this subdivision shall be extended as follows:

(A) By one year for a net operating loss attributable to income years beginning in 1991.

(B) By two years for a net operating loss attributable to income years beginning prior to January 1, 1991.

(4) The net operating loss attributable to income years beginning on or after January 1, 1987, and before January 1, 1994, shall be a net operating loss carryover to each of the 10 income years following the year of the loss if it is incurred by a corporation that was either of the following:

(A) Under the jurisdiction of the court in a Title 11 or similar case at any time prior to January 1, 1994. The loss carryover provided in the preceding sentence shall not apply to any loss incurred in an income year after the income year during which the corporation is no longer under the jurisdiction of the court in a Title 11 or similar case.

(B) In receipt of assets acquired in a transaction that qualifies as a tax-free reorganization under Section 368(a)(1)(G) of the Internal Revenue Code.

(f) For purposes of this section:

(1) ‘‘Eligible small business’’ means any trade or business that has gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the income year.

(2) Except as provided in subdivision (g), ‘‘new business’’ means any trade or business activity that is first commenced in this state on or after January 1, 1994.

(3) ‘‘Title 11 or similar case’’ shall have the same meaning as in Section 368(a)(3) of the Internal Revenue Code.

(4) In the case of any trade or business activity conducted by a partnership or an S corporation, paragraphs (1) and (2) shall be applied to the partnership or S corporation.

(g) For purposes of this section, in determining whether a trade or business activity qualifies as a new business under paragraph (2) of subdivision (e), the following rules shall apply:

(1) In any case where a taxpayer purchases or otherwise acquires all or any portion of the assets of an existing trade or business (irrespective of the form of entity) that is doing business in this state (within the meaning of Section 23101), the trade or business thereafter conducted by the taxpayer (or any related person) shall not be treated as a new business if the aggregate fair market value of the acquired assets (including real, personal, tangible, and intangible property) used by the taxpayer (or any related person) in the conduct of its trade or business exceeds 20 percent of the aggregate fair market value of the total assets of the trade or business being conducted by the taxpayer (or any related person). For purposes of this paragraph only, the following rules shall apply:

(A) The determination of the relative fair market values of the acquired assets and the total assets shall be made as of the last day of the first income year in which the taxpayer (or any related person) first uses any of the acquired trade or business assets in its business activity.

(B) Any acquired assets that constituted property described in Section 1221(1) of the Internal Revenue Code in the hands of the transferor shall not be treated as assets acquired from an existing trade or business, unless those assets also constitute property described in Section 1221(1) of the Internal Revenue Code in the hands of the acquiring taxpayer (or related person).

(2) In any case where a taxpayer (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (‘‘prior trade or business activity’’), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the taxpayer's (or any related person's) current or prior trade or business activities.

(3) In any case where a taxpayer, including all related persons, is engaged in trade or business activities wholly outside of this state and the taxpayer first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in paragraph (1)), the trade or business activity shall be treated as a new business under paragraph (2) of subdivision (e).

(4) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the taxpayer as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of paragraph (1) of this subdivision.

(5) ‘‘Related person’’ shall mean any person that is related to the taxpayer under either Section 267 or 318 of the Internal Revenue Code.

(6) ‘‘Acquire’’ shall include any transfer, whether or not for consideration.

(7) (A) For income years beginning on or after January 1, 1997, the term ‘‘new business’’ shall include any taxpayer that is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and as further amended, and that has not received regulatory approval for any product from the United States Food and Drug Administration.

(B) For purposes of this paragraph:

(i) ‘‘Biopharmaceutical activities’’ means those activities which use organisms or materials derived from organisms, and their cellular, subcellular, or molecular components, in order to provide pharmaceutical products for human or animal therapeutics and diagnostics. Biopharmaceutical activities make use of living organisms to make commercial products, as opposed to pharmaceutical activities which make use of chemical compounds to produce commercial products.

(ii) ‘‘Other biotechnology activities’’ means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(h) For purposes of corporations whose net income is determined under Chapter 17 (commencing with Section 25101), Section 25108 shall apply to each of the following:

(1) The amount of net operating loss incurred in any income year which may be carried forward to another income year.

(2) The amount of any loss carry forward which may be deducted in any income year.

(i) The provisions of Section 172(b)(1)(D) of the Internal Revenue Code, relating to bad debt losses of commercial banks, shall not be applicable.

(j) The Franchise Tax Board may prescribe appropriate regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, tiered ownership structures, or otherwise.

(k) The Franchise Tax Board may reclassify any net operating loss carryover determined under either paragraph (2) or (3) of subdivision (b) as a net operating loss carryover under paragraph (1) of subdivision (b) upon a showing that the reclassification is necessary to prevent evasion of the purposes of this section.

(*l*) Except as otherwise provided, the amendments made by the act adding this subdivision shall apply to net operating losses for income years beginning on or after January 1, 2000.

SEC. 10. The amendments made by this act to Section 10754.2 of the Revenue and Taxation Code, and the addition by this act of Section 10903 to the Revenue and Taxation Code, shall become operative only if AB 858 of the 1999–2000 Regular Session is enacted, in which case the amendments made by this act to Section 10754.2 of the Revenue and Taxation Code, and the addition by this act of Section 10903 to the Revenue and Taxation Code, shall become operative on the effective date of this act.

SEC. 11. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.

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